2016-TII-40-ITAT-MUM-INTL

IN THE INCOME TAX APPELLATE TRIBUNAL

"L" BENCH, MUMBAI

BEFORE SHRI C.N. PRASAD, JUDICIAL MEMBER AND

SHRI ASHWANI TANEJA, ACCOUNTANT MEMBER

ITA no.749/Mum./2015
(Assessment Year : 2010–11)

Galatea Limited, P.O. 1156 Industrial Area Dalton, Israel c/o Vaish Associates, Advocates 106, Peninsula Centre Dr. S.S. Rao, Parel Mumbai 400 012 PAN – AADCG8396D	……………. Appellant
v/s	
Dy. Commissioner of Income Tax International Taxation, Range–2(3)(2) Mumbai	……………. Respondent

Assessee by	:	Shri Bomi Daruwala a/w Ms. Priyanka Jain, CAs
Revenue by	:	Shri Jasbir Chauhan, CIT-DR

Date of Hearing- 13.01.2016	Date of Order –24.02.2016

O R D E R

PER ASWANI TANEJA, A.M.

This appeal has been filed by the assessee against the final assessment order dated 20th January 2015, passed by the Assessing Officer (in short 'AO') under section 143(3) r/w section 144C(13) of the Act, for the assessment year 2011–12 and also challenging the order dated 16th December 2014, passed by the Dispute Resolution Panel–III (in short 'DRP'), Mumbai, under section 144C(5) of the Income Tax Act, 1961 (in short '*the Act*'), on the following grounds:–

> *"1. That on the facts and circumstances of the case, the impugned assessment completed vide order dated 20.01.2015 under section 143(3) read with section 144C of the Income-tax Act, 1961 ('the Act'), is illegal and bad in law.*
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> *1.1. That the assessing officer erred on facts and in law in completing the assessment vide order dated 20.01.20 15 under section 143(3) rws 144C of the Act at an income of Rs. 17,39,01,465/- as against returned income of Rs. Nil.*
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> *1.2 That the DRP erred on facts and in law in the affirming the draft assessment order by passing a cryptic and non-speaking order, without judiciously considering the entire material and the submissions/ objections filed by the appellant.*
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> *2. That the assessing officer erred on facts and in law in holding the payments received by the appellant*

towards supply of software to the customers in India, as income in the nature of "royalty" within the meaning of Explanation 2(v) of section 9(1)(vi) of the Act and Article 12(3) of the Double Tax Avoidance Treaty between India and Israel (the Treaty') and liable to tax in India @ 10% of gross amount.

3. That the assessing officer erred on facts and in law in not appreciating that software formed integral part of the Galatea machines supplied by the appellant to customers in India without which such machines could not function and thereby the supply of the software like the payment for supply of the hardware was in the nature of business profits not liable to tax in India in the absence of permanent establishment of the appellant in India.

4. Without prejudice, the assessing officer erred on facts and in law in not appreciating that the software supplied to the customers in India only resulted in their acquiring a copyrighted article and not a copyrighted right and that the payment was the same did not constitute royalty as defined in Article 12(3) of the Treaty and was hence not liable to tax in India.

5. That the Assessing Officer erred in facts and in law in not appreciating that the definition of royalty in section 9(1)(vi) of the Act is not applicable in the case of the appellant owing to Article 12(3) of the Treaty, which has a separate definition of royalty.

6. That the assessing officer erred on facts and in law in not allowing credit of TDS amounting to Rs.8,52,664/- while finally computing the income tax liability, although the same was directed to be allowed in the assessment order.

7. That the assessing officer erred on facts and in law

in levying interest under section 234B of the Act.

8. That the assessing officer erred on facts and in law in initiating penalty proceedings under Section 271(1)(c) of the Act."

2. During the course of hearing, arguments were made by the Ld. Counsels Shri Bomi Daruwala, a/w Ms. Priyanka Jain (Chartered Accountants), on behalf of the assessee and Ld. Departmental Representative, Shri Jasbir Chouhan (Ld CIT-DR), on behalf of the Revenue. After hearing the parties, grounds of appeal raised by the assessee are being disposed of as under:–

3. Grounds no.1 to 1.2 are general in nature, hence, they do not require any specific adjudication.

4. In Grounds no. 2 to 5, the assessee has challenged the action of the lower authorities in bringing to tax the amount received by the assessee on account of sale of software as part of machinery by alleging the same to be income in the nature of *"Royalty"* within the meaning of section 9(1)(vi) of the Act.

5. During the course of hearing, it has been submitted by the Ld. Counsel for the assessee that the Assessing Officer has erred in law and facts in bringing to tax the impugned amount as income of the assessee on account of *"Royalty"*. Ld. Counsel has divided his arguments in three parts.

6. The first part of the argument of the Ld. Counsel for the assessee is that what has been sold by the assessee is not software as such, but 'Diamonds and Gems Scanning Machine' (hereinafter referred to as 'Machine' or 'Equipment' for the sake of brevity). Software was part of the machine which was required to make that machine operational. The customers who purchased the machine were not concerned with the software but with the functioning of the machine. Our attention has been drawn on various pages of the paper book showing that there was no separate sale of software. All the customers purchased machines along with requisite software to operate that machine. Pages–222, 223 and 224 of the paper book are the lists showing party–wise details and sales made by the assessee. Page–225 of the paper book is the certificate of Galatea Ltd. certifying that software supplied by it to the end user was integrated with various machine supplied by it and the software had no other independent use as such except to enable such machine to function. Our attention was also drawn on the copy of invoice to show that all the customers purchased machine and software both. Our attention was also drawn on some of the copies of End User License Agreement (EULA) entered between the assessee company and its customers to show that the software had no independent existence. It was integral part of the machine and the customer was not allowed to isolate the software from the machine or to re–engineer the

same. From various evidences and facts on record, it was shown by the Ld. Counsel for the assessee that the software was integral part of the machine and the transaction done with the customer was that of sale of machine and not of software. It was clarified by him that the software was separately mentioned in the invoice and its payments were also received separately for the purpose of proper assessment of custom duty etc and administrative convenience, but it was a transaction of predominantly sale of machine. He thus argued that it was a case of embedded software and, therefore, the transaction being predominantly sale of machine, the income arising there-from was not liable to be taxed in India under section 9(1)(vi). It was further submitted that since the undisputed facts on record are that assessee had no Permanent Establishment (P.E.) or business connection in India and, therefore, its business income was not liable to be taxed in India. In support of his proposition that in case of embedded software being integral part of machine, income on account of sale of software could not have been separately taxed as *"Royalty"* under section 9(1)(vi) of the Act, he relied upon the following judgments:–

i) DIT v/s Ericsson A.B., 343 ITR 470 (Delhi);

ii) DIT v/s Nokia Networks O.Y., 358 ITR 259 (Delhi);

iii) Bharati Airtel Limited v/s Commissioner of Customs, 286 ELT 270 (Bangalore); and

iv) CIT v/s Alcatel Lucent, Canada, 372 ITR 476 (Del.).

7. Second argument made by the Ld. Counsel for the assessee is that even if it is admitted that payments made to the customers of the assessee company towards software is not considered as integral part of the machine and liable to tax on standalone basis as *"Royalty",* and even if the amendment made in the law by way of insertion of Explanation–4 to section 9(1)(vi) by Finance Act, 2012, with retrospective effect from 1st June 1976 is taken into account, the said payment still cannot be regarded as royalty within the meaning of the term *"Royalty"* as used in Article–12 of Indo–Israel treaty. It was submitted that it is well settled position of law that in terms of section 90(2) of the Act, provisions of the 'Act' or 'Treaty' whichever is more beneficial, shall apply to the assessee. It was submitted that since no amendment had been made in the definition of the term *"Royalty"* as envisaged in Article–12 of the treaty, therefore, the case of the assessee was to be examined by interpreting the Articles of the treaty. It was submitted by him that perusal of Article 12(3) of the treaty shows that the term *"Royalty"* shall encompass payment of any kind received as consideration for use or transfer of copyright, whereas, the admitted facts of the case are that there is no

transfer of any copyright. Thus, the provisions of treaty should be read in preference to the provisions of the Act so long as they are more beneficial to the assessee in determining its tax liability. The amendment made in the provisions of the Act cannot be automatically read into the articles of the treaty, unless of course, corresponding amendment is made in the treaty also. For this proposition, he has relied upon the following judgments:–

i) DIT v/s Infrasoft Ltd., 39 Taxmann.com 88 (Del.);

ii) CIT v/s Siemens Aklcongesllschaft, 177 Taxmann 81 (Bom.);

iii) DIT v/s Nokia Networks O.Y., 358 ITR 259;

iv) B4U International Holdings Ltd. v/s DCIT, 148 TTJ 237 (Mum.); and

v) WNS North America Inc., v/s ADIT, ITA no.8621/ Mum./2010 (Mum.).

8. The third argument made by the Ld. Counsel for the assessee is that in any case, the impugned transactions could not be covered within the definition of *"Royalty"* as envisaged in section 9(1)(iv) since there was no transfer of any copyright. What was transferred at the best was a copyrighted article. It was submitted by him that if we go by definition of the term *"Royalty"* as per article–12(3) of Indo–Israel treaty, then unless

there is a transfer of copyright itself, there would not be any occasion to treat the amount of consideration as *"Royalty"*. He took us through section 14 of the Copyright Act, to demonstrate that there was no transfer of any copyright in this case. It was submitted that in this case, no source code was supplied by the assessee. The customer had no right to use or re–use the software elsewhere, the software could not have been re–issued to someone else by the customer, the software could have been used only as integral part of the machine. Under such circumstances, the consideration cannot fall within the scope of the term *"Royalty"*. In support of his proposition, he relied upon the following judgments:–

i) CIT v/s Dynamic Vertical Software India Pvt. Ltd., 332 ITR 222 (Del.);

ii) DIT v/s Nokia Networks O.Y. 358 ITR 259;

iii) Dassault Systems v/s DICT, 322 ITR 125 (AAR);

iv) Geoquest Systems B.V. v/s DIT, 327 ITR 001 (AAR);

v) Motorola Inc. v/s DCIT, 95 ITD 269 (Del.) (SB);

vi) TII Team Telecom International, 140 TTJ 649 (Mum);

vii) DIT v/s Infrasoft Ltd. 39 Taxmann.com 88 (Del.);

viii) Financial Software and Systems Pvt. Ltd. v/s DCIT, 47 Taxmann.com 410 (Chhenai);

ix) DDIT v/s Solid Works Corporation, 152 TTJ 570 (Mum.);

x) Aspect Software Inc., ITA no.221/Del./2013 dated 18th May 2015 (Del.); and

v) CIT v/s Alcatel Lucent, Canada, 372 ITR 476 (Del.).

9. He finally submitted that viewed from any angle, the amount of consideration received by the assessee was in effect part of sale consideration of the machine sold by it to various customers and, therefore, the same could not have been treated in the nature of *"Royalty"* liable to be taxed in India.

10. On the other hand, the Ld. Departmental Representative had also argued this issue at length. It was submitted by him that if software was integral part of the machine then there was no necessity to receive the payment separately and mentioning about the same separately in the invoice. It was further submitted that the software was received separately by e–mail, thus, under these circumstances, it could not be said that software was integral part of the machine. He placed reliance on the following judgment in support of his argument that impugned transaction was in the nature of *"Royalty"* liable to be taxed in India in the hands of the assessee company:

i) DDIT v/s Reliance Infocom Ltd., 37 CCH 69 (Mum.);

ii) CIT v/s Synopsis International Old Ltd., 212 Taxman 454 (Kar.) and

iii) CIT v/s Samsung Electronics Co. Ltd., 345 ITR 494 (Kar.)

11. It was submitted by him that after the amendment made by way of Explanation–4 in section 9(1)(vi), the consideration received by assessee for sale of software would now be undoubtedly covered within the definition of *"Royalty",* and that since the Explanation has been added with retrospective effect, therefore, the case of the assessee is clearly covered in the amended law and, therefore, the orders of the lower authorities should be upheld.

12. We have gone through the orders of the lower authorities and the submissions made and evidences shown to us as well as copies of judgments read and relied upon by both the parties in support of their respective arguments. The solitary dispute which is required to be addressed by us is that consideration received by the assessee towards software claimed to have been supplied as part of 'Diamonds & Gems Scanning Machine' would be liable to tax as "Royalty" in the hands of the assessee or not.

13. Brief background of the case is that the assessee is a company incorporated under the laws of Israel and is tax resident of Israel for the purpose of Indo–Israel Double Taxation Avoidance Agreement (in short referred to as DTAA or tax-treaty). The Ld. Counsel drew our attention to the tax residence certificate in this regard and these facts were on record, and no dispute has been raised by the Assessing Officer on this issue. Thus, admittedly, the assessee is a non–resident company. It appears that residential status of the assessee has been mentioned by mistake as "Resident" on the first page of the order passed by the DRP.

14. During the year, the assessee company was involved in the business of developing, manufacturing and servicing machinery, equipment, tools, supporting software, accessories, equipments, products, parts and materials for the diamond, gems and jewellery industry. It is 100% subsidiary of M/s Sarin Technologies Ltd., Israel. As a part of its business, during the year under consideration, the assessee company sold to its customers machines and operating software. In the invoice issued by the assessee company, the consideration was mentioned separately for the machine and operating software. Some of the customers deducted tax at source @ 10% from the payments made by them towards operating software and application software, treating the same as "Royalty" under

article 12(3) of the Israel tax treaty. But since the assessee was of the view that the aforesaid payments made by the customers did not constitute "Royalty", under the Israel tax treaty and the tax was wrongly withheld by the customers, it filed its return of income for the impugned assessment year at nil and claimed refund of the tax withheld / deducted by its customers. The Assessing Officer treated the same as taxable in the hands of the assessee in India. Being aggrieved, assessee filed its objection before the DRP wherein no relief was given and, therefore, still being aggrieved, the assessee approached the Tribunal.

15. On further analyzing the facts, it is noted that admitted facts on record are that the assessee had no business connection in India and it had no P.E. in India. This fact has not been disputed by the Assessing Officer. Rather we can say the Assessing Officer has proceeded on this admitted fact that the assessee has neither any P.E. nor business connection in India. Thus, under these circumstances, the impugned amount of consideration is not liable to be taxed as business income of the assessee. The taxability of the same, however, has to be examined in view of the provisions contained in clause (vi) of sub–section (1) of section 9 of the Act read with relevant provisions of Indo-Israel DTAA. On this issue, we have examined carefully all the arguments made by the Ld. Counsel

as well as counter submissions made by the Ld. Departmental Representative and we shall deal with the same hereunder:–

16. The first part of the argument made by the Ld. Counsel for the assessee is that the impugned consideration was received on account of sale of machine along with requisite software which formed integral part of machines sold by it to the customers. The whole dispute arose merely because value of software was separately mentioned. But, there was no separate transaction of sale of software and, therefore, it was predominantly transaction of sale of machine and, therefore, it could not have been brought within the definition of *"Royalty"* as envisaged in section 9(1)(vi) of the Act and, therefore, in the absence of there being any P.E. of the assessee in India, the income arising from sale of machine could not have been taxed in its hands in India.

17. We have carefully analyzed the facts of the case and arguments made by the Ld. Counsel for the assessee as well as counter arguments made by the Ld. Departmental Representative. The undisputed facts before us are that none of the customers have purchased only machine or only software. There was no customer who purchased only software. Ld. Counsel for the assessee drew our attention on various pages of the paper book to establish that the machine sold by the assessee could not be made operational or functional in the

absence of operating software along with the application software. These facts were not controverted by the Ld. Departmental Representative during the course of hearing in response to a specific query put to him by the Bench. It is noted that complete details have been given by the assessee in the paper book at Page–222 and 224. Our attention was also drawn on certificate from the assessee enclosed at Page–225 of the paper book certifying that software supplied by the assessee to end user was for integration with the machine supplied by the assessee and that this software had no other independent use as such, except to enable such machine to function. We have also gone through the End User License Agreement (EULA) entered into by the assessee with the customers wherein there are various clauses which indicate that the software supplied by the assessee was meant only and exclusively for the purpose of making the said machine functional. Clause 2.1 of the agreement provides that customer is granted non–exclusive, non–transferable limited license to use the software and related knowhow on the machine for the sole purpose of scanning the internal / external feature of rough diamond and creating a three dimensional image of these features of rough diamond. Clause 2.2 of the agreement puts certain restrictions upon the customers for any other use of the software in any other machine. This clause restrains the customer from duplicating the software or making any copies, modifications, isolating the software and making it available as a standalone data base or product, removing any product identification, copyright or other proprietary notice from the software or decompiling, disassembling, reverse engineering, or making any other attempt to reconstruct or discover the source code, etc. This clause clearly lays down that customer shall not reproduce the software or any of the documentation provided in connection with the software or related knowhow. It is further noted that clause 6.2 of the said agreement lays down that the assessee is and shall remain sole and exclusive owner of the right, title and interest in the software and related know. This software cannot be used by the customer except for the operation of the machine. It is further noted by us that the machine was equipped with requisite security controls and hardware locks to stop any type of misuse of software. Clause 10.2 of one of the agreement available at Page–49 is reproduced hereunder for the sake of ready reference:–

> *"10.2 SARIN INDIA acknowledges that GALATEA may use software and/or hardware locks or other protective mechanisms to regulate the use of software. SARIN INDIA shall not evade or override such software/hardware locks or protective devices and shall immediately inform GALATEA upon learning that any user has defeated such devices. SARIN INDIA agrees to cooperate fully with GALATEA in its efforts to protect Software from unlawful or unauthorized use."*

18. From the aforesaid facts and features of the transactions analysed by us, it could be concluded that the customer was not interested in the hardware alone or in the software alone. He was interested in the system as a whole and functioning of the machine. Operating software enable the machine to run and the application of software made functioning of the machine possible. It is an undisputed fact that the software which was loaded onto the hardware did not have any independent existence as such. The software supplied was ostensibly and undisputedly an integral part of the hardware. Now, since the hardware and software constituted one integrated system, part of the payment thereof cannot be earmarked towards sale of hardware and the other part towards *"Royalty"* for use of software as such. Thus, in our considered view, the dominant character and essence of the transaction was sale of machine by the assessee. The software, independently, had no value for the customer. He was concerned with as only the functioning of the machine and benefits of use provided by machine.

19. The only argument given by the Ld. Departmental Representative to counter the submissions of the Ld. Counsel for the assessee was that in this case, payment was made separately for the software at the time of sale of machine as well as subsequently and that software was provided by e–mail and, therefore, separate treatment should be given to the software. In our considered opinion, argument of the Ld.

Departmental Representative would not be sustainable under the law. The dominant and fundamental character of the transaction shall not be altered because of these two features only. The break–up of invoice value of hardware and software may be as a result of some other legal requirement or as a matter of convenience or an agreement between buyer and seller. It has been submitted that separate values were given for the purpose of proper assessment of custom duty to be levied at the time of imports of the machines. Further, software has been supplied separately by e–mail for various security reasons and to enable the customer to have the benefits of updated technologies. Similarly, separate payments have been made at the time of sale and subsequently by customer as a matter of terms between both the parties keeping in view various factors such as financial and administrative convenience and commercial expediency. The dominant and essential character of the transaction was sale of machine by the assessee and purchase of the same by the customer, and it shall remain the same with or without these two features.

20. The view taken by us is not *res-integra*. Our view is supported by many judgments brought to our notice.

21. In case of CIT v/s Alcatel Lucent, Canada, 372 ITR 476 (Delhi), Hon'ble Delhi High Court has analyzed this situation in detail and after discussing entire law available, held that supply

of embedded software (which was part of the hardware supplied to assessee's customers by it) did not constitute "Royalty" and, therefore, section 9(1)(vi) was not attracted and for the same reasons, the article 13(3) of the DTAA was not involved. Relevant portion of the order of the judgment is reproduced herein for the sake of ready reference:–

"The Revenue claims to be aggrieved by the order dated 04.04.2014 of the Income Tax Appellate Tribunal (hereinafter referred to as "the ITAT") in several connected appeals preferred by it, all of which were rejected by the ITAT. It argues that the ITAT erred in law in not considering that the income from supply of software embedded in the hardware equipment or otherwise to customers in India amounts to royalty under Section 9(1)(vi) of the Income Tax Act and under Article 13(3) of the Double Taxation Avoidance Agreement (DTTA) between India and France, Canada, Germany, China etc.

4. Re-assessment proceedings were initiated for the year under consideration. The assessee claimed that the income declared originally in the assessment proceedings be treated as return filed in the assessment proceedings. In the re-assessment order, the AO observed that the assessee, a company incorporated in France and other concerned countries used to manufacture, trade and supply equipments and services for GSM Cellular Radio Telephones Systems. The assessee had supplied hardware and software to various entities in India. Software licensed by the assessee embodies the process which is required to control and manage the specific set of activities involved in the business use of its customers. Software also made available the process to its customers, who used it to carry out their business activities. In this view of the matter, the AO felt that the consideration of supply of software amounted to royalty under Section 9(1)(vi) of the Income Tax Act. The CIT(Appeals) – to whom the assessee appealed and *later the ITAT to whom the Revenue appealed concurrently held that the supply of embedded software (which was part of the hardware supplied to the assessee's customers by it) under consideration did not constitute royalty and, therefore, Section 9(1)(vi) was not attracted and for the same reasons, Article 13(3) of the DTAA was not involved.*

5. We have noticed, at the outset, that the ITAT had relied upon the ruling of this Court in Director of Income Tax V. Ericsson A.B. 343 ITR 470 wherein identical argument with respect to whether consideration paid towards supply of software along with hardware – rather software embedded in the hardware amounted to royalty. After noticing several contentions of the revenue, this Court held in Ericsson A.B. (supra) as follows:-

> *"54. It is difficult to accept the aforesaid submissions in the facts of the present case. We have already held above that the assessee did not have any business connection in India. We have also held that the supply of equipment in question was in the nature of supply of goods. Therefore, this issue is to be examined keeping in view these findings. Moreover, another finding of fact is recorded by the Tribunal that the Cellular Operator did not acquire any of the copyrights referred to in Section 14 (b) of the Copyright Act, 1957.*
>
> *55. Once we proceed on the basis of aforesaid factual findings, it is difficult to hold that payment made to the assessee was in the nature of royalty either under the Income-Tax Act or under the DTAA. We have to keep in mind what was sold by the assessee to the Indian customers was a GSM which consisted both of the hardware as well as the software, therefore, the Tribunal is right in holding that it was not permissible for the Revenue to assess the same under two different articles. The software that was loaded on the hardware did not have any independent existence. The software supply is an integral part of the GSM mobile telephone*

system and is used by the cellular operator for providing the cellular services to its customers. There could not be any independent use of such software. The software is embodied in the system and the revenue accepts that it could not be used independently. This software merely facilitates the functioning of the equipment and is an integral part thereof. On these facts, it would be useful to refer to the judgment of the Supreme Court in TATA Consultancy Services Vs. State of Andhra Pradesh (2004) 271 ITR 401 (SC), wherein the Apex Court held that software which is incorporated on a media would be goods, and therefore, liable to sales tax. Following discussion in this behalf is required to be noted:-"In our view, the term "goods" as used in Article 366(12) of the Constitution of India and as defined under the said Act are very wide and include all types of movable properties, whether those properties be tangible or intangible. We are in complete agreement with the observations made by this Court in Associated Cement Companies Ltd. (supra). A software programme may consist of various commands which enable the computer to perform a designated task. The copyright in that programme may remain with the originator of the programme. But the moment copies are made and marketed, it becomes goods, which are susceptible to sales tax. Even intellectual property, once it is put on to a media, whether it be in the form of books or canvas (In case of painting) or computer discs or cassettes, and marketed would become "goods". We see no difference between a sale of a software programme on a CD/floppy disc from a sale of music on a cassette/CD or a sale of a film on a video cassette/CD. In all such cases, the intellectual property has been incorporated on a media for purposes of transfer. Sale is not just of the media which by itself has very little value. The software and the media cannot be split up. What the buyer purchases and pays for is not the disc or the CD. As in the case of paintings *or books or music or films the buyer is purchasing the intellectual property and not the media i.e. the paper or cassette or disc or CD. Thus a transaction sale of computer software is clearly a sale of "goods" within the meaning of the term as defined in the said Act. The term "all materials, articles and commodities" includes both tangible and intangible/incorporeal property which is capable of abstraction, consumption and use and which can be transmitted, transferred, delivered, stored, possessed etc. The software programmes have all these attributes…*

In Advent Systems Ltd. v. Unisys Corpn, (925 F. 2d 670 (3rd Cir. 1991)), relied on by Mr. Sorabjee, the court was concerned with interpretation of uniform civil code which "applied to transactions in goods". The goods therein were defined as "all things (including specially manufactured goods) which are moveable at the time of the identification for sale". It was held:

"Computer programs are the product of an intellectual process, but once implanted in a medium are widely distributed to computer owners. An analogy can be drawn to a compact disc recording of an orchestral rendition. The music is produced by the artistry of musicians and in itself is not a "good," but when transferred to a laser-readable disc becomes a readily merchantable commodity. Similarly, when a professor delivers a lecture, it is not a good, but, when transcribed as a book, it becomes a good.

That a computer program may be copyrightable as intellectual property does not alter the fact that once in the form of a floppy disc or other medium, the program is tangible, moveable and available in the marketplace. The fact that some programs may be tailored for specific purposes need not alter their status as "goods" because the Code definition includes "specially manufactured goods."

> *56. A fortiorari when the assessee supplies the software which is incorporated on a CD, it has supplied tangible property and the payment made by the cellular operator for acquiring such property cannot be regarded as a payment by way of royalty."*

6. This Court also noticed that the ITAT had in addition relied upon other judgment of this Court i.e. Director of Income Tax V. M/s. Nokia Networks, (2013) 358 ITR 259 (Delhi).

7. In view of this settled position, this court is of the opinion that no substantial question of law arises. The appeal is accordingly dismissed"

22. Thus, from the perusal of the aforesaid judgment, it may be noted that the Hon'ble High Court has also taken into account various other judgments available such as (i) DIT v/s Ericson A.B., (Delhi High Court), (ii) DIT v/s Nokia Networks O.Y. (Delhi High Court) and (iii) Tata Consultancy Services (SC), etc.

23. Further, on this issue, judgment of CESTAT in case of Bharati Airtel Ltd. v/s Commissioner of Customs, 286 ELT 270 (Bangalore) is very useful. It has been held that embedded software which is meant for making a computer operational has to be considered as part of hardware. If the software is meant for specific performance of machine and forms its integral part, then value of such software cannot be excluded and separately assessed. In Para–4.2(b), it was further clarified in the said

judgment that it is not necessary that software which is embedded / etched / burnt is to be included in the part of hardware. What is to be seen mainly is that whether the software has got its independent value and marketable as such or the sole purpose of software is to make the machine operational and functional. Para–14.2 of the judgment is reproduced for the sake of ready reference:–

> *"14.2 On a close analysis of the decisions relied upon by both sides, in matters relating to classification/valuation, the following important guidelines/principles emerge apart from the meanings of various relevant technical terms:*
>
> *(a) In classification of products, the commercial understanding is more relevant than technical specifications except in respect of commodities for which such specifications are prescribed requiring the assistance of experts in the respective fields. In other words, the method to be adopted for classification is to be based on easily understandable parameters.*
>
> *(b)* ***The decisions in respect of software and hardware in relation to computer are to the effect that if any software is embedded/etched/burnt then it has to be included as part of the hardware and cannot be treated as stand-alone software and that the value of such embedded software should be part of the value of computer. However, it cannot be concluded that only the value of software which is embedded/etched/burnt is to be included in the value of the computer.***

(c) It is not as if essentiality is an irrelevant criterion for determining the classification/valuation and at the same time essentiality is not the sole criterion for deciding the classification or determination of value.

(d) In the matter of valuation, one of the important aspects to be taken into account is the condition of the goods/product at the time the goods leave the factory (as held by Honble Supreme Court in para 13 of Anjaleem case). Similarly, in respect of imported goods, the condition of the goods/product at the time of import is relevant.

*(e) **In certain circumstances, software loses its identity as software and becomes part and parcel of hardware** and similarly, in certain circumstances, hardware loses its identity as hardware and becomes part and parcel of software…………..”*

24. Thus, from the aforesaid judgments, it is clearly evident that Courts have held that where software is supplied predominantly as part of an equipment and if the software loses its identity and the equipment takes over the main objects of the transaction then it has to be treated as transaction of sale and purchase of machine and not as transaction for sale and purchase of software. It has already been established on the basis of facts before us that the transaction involved in this case was that of sale of diamond scanning machine. The customer had no interest in the software except to the extent of effective functioning of the machine. Thus, in view of the judgments discussed above, it

has to be treated as transaction of sale of machine in the hands of the assessee and the amount bifurcated for software cannot be treated differently as consideration in the nature of *"Royalty"* as envisaged under section 9(1)(vi) of the Act and since the assessee has no P.E. in India, as per admitted facts on record, the amount of profit arising on receipt of sale consideration of machine would not be liable to be taxed in its hands in India.

25. We have also examined second argument of the Ld. Counsel for the assessee wherein it has been submitted in detail that in case there is some conflict between the provisions as contained in articles of tax-treaty and provisions of the Act then whatever course is beneficial to the assessee in terms of determination of its tax liability, the same should be allowed to be followed by the assessee as per well accepted position of law. It has been further submitted that if the amendment has been made in the provisions of the Act, the same shall not be automatically and by implication imported into the articles of the treaty unless of course a corresponding amendment is made in the tax treaty as well. It was thus submitted that amendment made in section 9(1)(vi) by way of insertion of an Explanation by Finance Act, 2012, for extending the scope of the term *"Royalty"*, shall not be read into the provisions of Article 12.3 of the Indo–Israel tax treaty incorporated in the treaty for explaining meaning of the term 'Royalty'.

26. We have carefully considered this argument of the assessee also. We find that position of law on this aspect is clear. Recently, Hon'ble Bombay High Court in DIT v/s A.P. Mollar Maersk, ITA no.1306/2013, vide order dated 29th April 2015 reiterated the same position by observing as under:–

> *"12. Our attention is also drawn to the decision of this Court in the case of Commissioner of Income-tax V/s. Siemens Aktiongeselleschaft reported in [2009] 310 ITR 320 (Bom), wherein this Court has held that once there is a treaty between two sovereign nations, though it is open to a sovereign Legislature to amend its laws, a DTAA entered into by the Government, in exercise of the powers conferred by section 90(1) of the Act must be honoured. The provisions of Section 9 Income Tax Act were applicable and the provisions of DTAA, if more beneficial than the I.T. Act, the provisions of DTAA would prevail. Thus, in the instant case also, it is not possible for the revenue to unilaterally decide contrary to the provisions of the DTAA."*

27. In terms of section 90(2) of the Act, provisions of the Act or the treaty, whichever is more beneficial shall apply to the assessee. Further, amendment to the Act cannot be automatically read into the treaty unless the treaty is also amended. In the case of CIT v/s Siemens Aktiongesellschaft, supra, this proposition has been reaffirmed by the Hon'ble Bombay High Court after analysing the law in detail.

28. In the case of DIT v/s Nokia Networks O.Y., 358 ITR 259, Hon’ble Delhi High Court has further explained this position following the aforesaid judgment of Hon'ble Bombay High Court by observing that an amendment made in the provisions of the Act cannot be automatically read into the treaty.

29. Similarly, Mumbai Bench of the Tribunal in B4U International Holdings Ltd., 148 TTJ 237, has also reiterated the same position and held that in the absence of corresponding amendment in the tax treaty, the amendment made in the Act cannot be given effect to.

30. Further, in the case of W.N.S. North America Inc. v/s ADIT, Mumbai Bench of the Tribunal in ITA no.8621/Mum./2010, held as under:–

> "...If *there is no amendment to the provision of the Treaty but there is some amendment adverse to the assessee in the Act, which provision has been specifically defined in the Treaty or there is no reference in the Treaty to the adoption of such provision from the Act, again the mandate of section 90(2) shall apply as per which the provisions of the Act or the Treaty, whichever is more beneficial to the assessee shall apply. Going by such rule, the amendment to the Act shall have no unfavorable effect on the computation of total income of the assessee."*

31. Similarly, Hon'ble Delhi High Court in DIT v/s Infrasoft Ltd., 39 Taxmann.com 88 (Del.) has analyzed this issue in detail and held that in case provisions of the Act are more burdensome then the provisions of the Act would not apply and the assessee would be governed by the provisions of DTAA. Hon'ble Delhi High Court followed the judgment of Hon'ble Supreme Court in Azadi Bachao Andolan, 263 ITR 706 (SC), wherein it was laid down that in case of conflict, the provisions of DTAA would override the statutory provisions of the Act so long as these are more beneficial to the assessee. It was further held by the Hon'ble High Court that in the absence of any corresponding amendment in DTAA, there was no need to examine effect of subsequent amendment to section 9(1)(vi) and also fact as to whether amount received for use of software would be “Royalty” in terms thereof.

32. Recently, Hon’ble Delhi High Court in the case of DIT v. **NEW SKIES SATELLITE BV** in its order dated 8th February 2016 in ITA NO.473/M/12 got an occasion to analyse in detail entire law on the issue that amendment made in the domestic law i.e. Income Tax Act shall not be automatically read in to provision of DTAA, unless specific amendment is made by both the countries in the DTAA, as the DTAA is an agreement of two sovereign countries and one of them cannot unilaterally amendment the terms of the agreement. Merely, on the basis

of some amendments made in the domestic law, the Relevant portion of the judgment is reproduced below:

DIT vs NEW SKIES SATELLITE BV (Order Dt 08.02.2016 in ITA 473/2012) (Delhi High Court)

"This Court is of the view that no amendment to the Act, whether retrospective or prospective can be read in a manner so as to extend in operation to the terms of an international treaty. In other words, a clarificatory or declaratory amendment, much less one which may seek to overcome an unwelcome judicial interpretation of law, cannot be allowed to have the same retroactive effect on an international instrument effected between two sovereign states prior to such amendment. In the context of international law, while not every attempt to subvert the obligations under the treaty is a breach, it is nevertheless a failure to give effect to the intended trajectory of the treaty. Employing interpretive amendments in domestic law as a means to imply contoured effects in the enforcement of treaties is one such attempt, which falls just short of a breach, but is nevertheless, in the opinion of this Court, indefensible. The Vienna Convention on the Law of Treaties, 1969 ("VCLT") is universally accepted as authoritatively laying down the principles governing the law of treaties. Article 39 therein states the general rule regarding the amendment of treaties and provides that a treaty may be amended by agreement between the parties. The rules laid down in Part II of the VCLT apply to such an agreement except insofar as the treaty may otherwise provide. This provision therefore clearly states that an amendment to a treaty must be brought about by agreement between the parties. Unilateral amendments to treaties are therefore categorically

prohibited. We do not however rest our decision on the principles of the VCLT, but root it in the inability of the Parliament to effect amendments to international instruments and directly and logically, the illegality of any Executive action which seeks to apply domestic law amendments to the terms of the treaty, thereby indirectly, but effectively amending the treaty unilaterally. As held in Azadi Bachao Andolan39these treaties are creations of a different process subject to negotiations by sovereign nations. The Madras High Court, in Commissioner of Income Tax v VR. S.RM. Firms Ors40 held that "tax treaties are...... considered to be mini legislation containing in themselves all the relevant aspects or features which are at variance with the general taxation laws of the respective countries". Thus, an interpretive exercise by the Parliament cannot be taken so far as to control the meaning of a word expressly defined in a treaty. Parliament, supreme as it may be, is not equipped, with the power to amend a treaty. It is certainly true that law laid down by the Parliament in our domestic context, even if it were in violation of treaty principles, is to be given effect to; but where the State unilaterally seeks to amend a treaty through its legislature, the situation becomes one quite different from when it breaches the treaty. In the latter case, while internationally condemnable, the State's power to breach very much exists; Courts in India have no jurisdiction in the matter, because in the absence of enactment through appropriate legislation in accordance with Article 253 of the Constitution, courts do not possess any power to pronounce on the power of the State to enact a law contrary to its treaty obligations. The domestic courts, in other words, are not empowered to legally strike down such action, as they cannot dictate the executive action of the State in the context of an international treaty, unless of *course, the Constitution enables them to. That being said, the amendment to a treaty is not on the same footing. The Parliament is simply not equipped with the power to, through domestic law, change the terms of a treaty. A treaty to begin with, is not drafted by the Parliament; it is an act of the Executive Logically therefore, the Executive cannot employ an amendment within the domestic laws of the State to imply an amendment within the treaty. Moreover, a treaty of this nature is a carefully negotiated economic bargain between two States. No one party to the treaty can ascribe to itself the power to unilaterally change the terms of the treaty and annul this economic bargain. It may decide to not follow the treaty, it may chose to renege from its obligations under it and exit it, but it cannot amend the treaty, especially by employing domestic law. The principle is reciprocal. Every treaty entered into by the Indian State, unless self-executory, becomes operative within the State once Parliament passes a law to such effect, which governs the relationship between the treaty terms and the other laws of the State. It then becomes part of the general conspectus of domestic law. Now, if an amendment were to be effected to the terms of such treaty, unless the existing operationalizing domestic law states that such amendments are to become automatically applicable, Parliament will have to by either a separate law, or through an amendment to the original law, make the amendment effective. Similarly, amendments to domestic law cannot be read into treaty provisions without amending the treaty itself. On a final note, India's change in position to the OECD Commentary cannot be a fact that influences the interpretation of the words defining royalty as they stand today. The only manner in which such change in position can be relevant is if such change is incorporated into the agreement itself and not* *otherwise. A change in executive position cannot bring about a unilateral legislative amendment into a treaty concluded between two sovereign states. It is fallacious to assume that any change made to domestic law to rectify a situation of mistaken interpretation can spontaneously further their case in an international treaty. Therefore, mere amendment to Section 9(1)(vi) cannot result in a change. It is imperative that such amendment is brought about in the agreement as well. Any attempt short of this, even if it is evidence of the State's discomfort at letting data broadcast revenues slip by, will be insufficient to persuade this Court to hold that such amendments are applicable to the DTAAs."*

33. Thus, from the above judgments, the position of law is very clear that provisions of Indo–Israel treaty would be preferred over the provisions of the Act, since there is no amendment in the treaty and the Department is seeking to put more tax liability upon the assessee taking help of amendment made in section 9(1)(vi).

34. We have gone through the provisions of Article–12 of India Israel tax treaty which defines the term *"Royalty"*. Article 12(3) has revised this term *"Royalty"* as under:–

"(3). The term "Royalty" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any

> *copyright of literary, artistic or scientific work including cinematograph film, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience."*

35. Thus, the status of the provisions in the treaty is kept same as was in the pre–amended law as contained in the provisions of the Act. According to these provisions of the treaty, as has been explained in various judgments, transfer of copyright is different from transfer of copyrighted article. Thus, in view of the facts of the case before us, even if payment for software is taxed separately from hardware, on a standalone basis, even then the same would not fall within the scope of Article–12(3) since there was merely transfer of a copyrighted article, and not the copyright or any rights contained therein. This position is substantially clarified once we go through various clauses of agreement entered into by the assessee with the customers called as End User License Agreement. We have already discussed and explained effect of the various clauses of these agreements in earlier part of the order and do not find it appropriate to discuss and reproduce the same once again for the sake of brevity.

36. It is further noted by us that the aforesaid position, as contained in the pre–amended law or as contained in Article–12(3) of the Act tax treaty has been discussed at length by

various Courts of the Country. We have discussed some of these judgments hereunder:–

i) DIT v/s Infrasoft Ltd., 39 Taxmann.com 88 (Del.), Hon'ble High Court discussed and analysed these provisions in detail, in the identical facts. Some of the relevant observations of the High Court are reproduced hereunder:–

"85. The Licensing Agreement shows that the license is non-exclusive, non-transferable and the software has to be uses in accordance with the Agreement. Only one copy of the software is being supplied for each site. The licensee is permitted to make only one copy of the software and associated support information and that also for backup purposes. It is also stipulated that the copy so made shall include Infrasoft's copyright and other proprietary notices. All copies of the Software are the exclusive property of Infrasoft. The Software includes a licence authorisation device, which restricts the use of the Software. The software is to be used only for Licensee's own business as defined within the Infrasoft Licence Schedule. Without the consent of the Assessee the software cannot be loaned, rented, sold, sublicensed or transferred to any third party or used by any parent, subsidiary or affiliated entity of Licensee or used for the operation of a service bureau or for data processing. The Licensee is further restricted from making copies, decompile, disassemble or reverse-engineer the Software without Infrasoft"s written consent. The Software contains a mechanism which Infrasoft may activate to deny the Licensee use of the Software in the event that the Licensee is in breach of payment terms or any other provisions of this

Agreement. All copyrights and intellectual property rights in and to the Software, and copies made by Licensee, are owned by or duly licensed to Infrasoft.

86. The Licensing Agreement shows that the license is non-exclusive, non-transferable and the software has to be uses in accordance with the agreement. Only one copy of the software is being supplied for each site. The licensee is permitted to make only one copy of the software and associated support information and that also for backup purposes. It is also stipulated that the copy so made shall include Infrasoft"s copyright and other proprietary notices. All copies of the Software are the exclusive property of Infrasoft. The Software includes a licence authorisation device, which restricts the use of the Software. The software is to be used only for Licensee's own business as defined within the Infrasoft Licence Schedule. Without the consent of the Assessee the software cannot be loaned, rented, sold, sublicensed or transferred to any third party or used by any parent, subsidiary or affiliated entity of Licensee or used for the operation of a service bureau or for data processing. The Licensee is further restricted from making copies, decompile, disassemble or reverse-engineer the Software without Infrasoft's written consent. The Software contains a mechanism which Infrasoft may activate to deny the Licensee use of the Software in the event that the Licensee is in breach of payment terms or any other provisions of this Agreement. All copyrights and intellectual property rights in and to the Software, and copies made by Licensee, are owned by or duly licensed to Infrasoft.

87. In order to qualify as royalty payment, it is necessary to establish that there is transfer of all or any rights (including the granting of any licence) in respect of copyright of a literary, artistic or scientific work. In order to treat the consideration paid by the Licensee as *royalty, it is to be established that the licensee, by making such payment, obtains all or any of the copyright rights of such literary work. Distinction has to be made between the acquisition of a "copyright right" and a "copyrighted article". Copyright is distinct from the material object, copyrighted. Copyright is an intangible incorporeal right in the nature of a privilege, quite independent of any material substance, such as a manuscript. Just because one has the copyrighted article, it does not follow that one has also the copyright in it. It does not amount to transfer of all or any right including licence in respect of copyright. Copyright or even right to use copyright is distinguishable from sale consideration paid for "copyrighted" article. This sale consideration is for purchase of goods and is not royalty.*

88. The license granted by the Assessee is limited to those necessary to enable the licensee to operate the program. The rights transferred are specific to the nature of computer programs. Copying the program onto the computer's hard drive or random access memory or making an archival copy is an essential step in utilizing the program. Therefore, rights in relation to these acts of copying, where they do no more than enable the effective operation of the program by the user, should be disregarded in analyzing the character of the transaction for tax purposes. Payments in these types of transactions would be dealt with as business income in accordance with Article 7.

89. There is a clear distinction between royalty paid on transfer of copyright rights and consideration for transfer of copyrighted articles. Right to use a copyrighted article or product with the owner retaining his copyright, is not the same thing as transferring or assigning rights in relation to the copyright. The enjoyment of some or all the rights which the copyright *owner has, is necessary to invoke the royalty definition. Viewed from this angle, a non-exclusive and non-transferable licence enabling the use of a copyrighted product cannot be construed as an authority to enjoy any or all of the enumerated rights ingrained in Article 12 of DTAA. Where the purpose of the licence or the transaction is only to restrict use of the copyrighted product for internal business purpose, it would not be legally correct to state that the copyright itself or right to use copyright has been transferred to any extent. The parting of intellectual property rights inherent in and attached to the software product in favour of the licensee/customer is what is contemplated by the Treaty. Merely authorizing or enabling a customer to have the benefit of data or instructions contained therein without any further right to deal with them independently does not, amount to transfer of rights in relation to copyright or conferment of the right of using the copyright. The transfer of rights in or over copyright or the conferment of the right of use of copyright implies that the transferee/licensee should acquire rights either in entirety or partially co-extensive with the owner/ transferor who divests himself of the rights he possesses pro tanto.*

90. The license granted to the licensee permitting him to download the computer programme and storing it in the computer for his own use is only incidental to the facility extended to the licensee to make use of the copyrighted product for his internal business purpose. The said process is necessary to make the programme functional and to have access to it and is qualitatively different from the right contemplated by the said paragraph because it is only integral to the use of copyrighted product. Apart from such incidental facility, the licensee has no right to deal with the product just as the owner would be in a position to do.

91. There is no transfer of any right in respect of copyright by the Assessee and it is a case of mere transfer of a copyrighted article. The payment is for a copyrighted article and represents the purchase price of an article and cannot be considered as royalty either under the Income Tax Act or under the DTAA.

92. The licensees are not allowed to exploit the computer software commercially, they have acquired under licence agreement, only the copy righted software which by itself is an article and they have not acquired any copyright in the software. In the case of the Assessee company, the licensee to whom the Assessee company has sold/licensed the software were allowed to make only one copy of the software and associated support information for backup purposes with a condition that such copyright shall include Infrasoft copyright and all copies of the software shall be exclusive properties of Infrasoft. Licensee was allowed to use the software only for its own business as specifically identified and was not permitted to loan/rent/sale/sub-licence or transfer the copy of software to any third party without the consent of Infrasoft.

93. The licensee has been prohibited from copying, decompiling, de-assembling, or reverse engineering the software without the written consent of Infrasoft. The licence agreement between the Assessee company and its customers stipulates that all copyrights and intellectual property rights in the software and copies made by the licensee were owned by Infrasoft and only Infrasoft has the power to grant licence rights for use of the software. The licence agreement stipulates that upon termination of the agreement for any reason, the licensee shall return the software including supporting information and licence authorization device to Infrasoft.

94. The incorporeal right to the software i.e. copyright remains with the owner and the same was not transferred by the Assessee. The right to use a copyright in a programme is totally different from the right to use a programme embedded in a cassette or a CD which may be a software and the payment made for the same cannot be said to be received as consideration for the use of or right to use of any copyright to bring it within the definition of royalty as given in the DTAA. What the licensee has acquired is only a copy of the copyright article whereas the copyright remains with the owner and the Licensees have acquired a computer programme for being used in their business and no right is granted to them to utilize the copyright of a computer programme and thus the payment for the same is not in the nature of royalty.

95. We have not examined the effect of the subsequent amendment to section 9 (1)(vi) of the Act and also whether the amount received for use of software would be royalty in terms thereof for the reason that the Assessee is covered by the DTAA, the provisions of which are more beneficial.

96. The amount received by the Assessee under the licence agreement for allowing the use of the software is not royalty under the DTAA.

97. What is transferred is neither the copyright in the software nor the use of the copyright in the software, but what is transferred is the right to use the copyrighted material or article which is clearly distinct from the rights in a copyright. The right that is transferred is not a right to use the copyright but is only limited to the right to use the copyrighted material and the same does not give rise to any royalty income and would be business income.

98. We are not in agreement with the decision of the Andhra Pradesh High Court in the case of Samsung Electronics Co. Ltd (supra) that right to make a copy of the software and storing the same in the hard disk of the designated computer and taking backup copy would amount to copyright work under section 14(1) of the Copyright Act and the payment made for the grant of the licence for the said purpose would constitute royalty. The license granted to the licensee permitting him to download the computer programme and storing it in the computer for his own use was only incidental to the facility extended to the licensee to make use of the copyrighted product for his internal business purpose. The said process was necessary to make the programme functional and to have access to it and is qualitatively different from the right contemplated by the said provision because it is only integral to the use of copyrighted product. The right to make a backup copy purely as a temporary protection against loss, destruction or damage has been held by the Delhi High Court in DIT v. M/s Nokia Networks OY (Supra) as not amounting to acquiring a copyright in the software.

99. In view of the above we accordingly hold that what has been transferred is not copyright or the right to use copyright but a limited right to use the copyrighted material and does not give rise to any royalty income.

100. The question of law is thus answered in favour of the Assessee and against the Revenue that the Income Tax Appellate Tribunal was right in holding that the consideration received by the respondent Assessee on grant of licenses for use of software is not royalty within the meaning of Article 12(3) of the Double Taxation Avoidance Agreement between India and the United States of America. 101. The appeal is *accordingly dismissed leaving the parties to bear their own costs."*

ii) In the case of Ericsson A.B. v/s DIT (supra), Delhi High Court held that consideration for use of computer software in the absence of transfer of copyright therein would not constitute *"Royalty"*. Some of the relevant observations of the High Court are reproduced hereunder:–

"59. Be as it may, in order to qualify as royalty payment, within the meaning of Section 9(1)(vi) and particularly clause (v) of Explanation-II thereto, it is necessary to establish that there is transfer of all or any rights (including the granting of any license) in respect of copyright of a literary, artistic or scientific work. Section 2 (o) of the Copyright Act makes it clear that a computer programme is to be regarded as a 'literary work'. Thus, in order to treat the consideration paid by the cellular operator as royalty, it is to be established that the cellular operator, by making such payment, obtains all or any of the copyright rights of such literary work. In the presence case, this has not been established. It is not even the case of the Revenue that any right contemplated under Section 14 of the Copyright Act, 1957 stood vested in this cellular operator as a consequence of Article 20 of the Supply Contract. Distinction has to be made between the acquisition of a "copyright right" and a "copyrighted article".

60. Mr. Dastur is right in this submission which is based on the commentary on the OECD Model Convention. Such a distinction has been accepted in a recent ruling *of the Authority for Advance Ruling (AAR) in Dassault Systems KK., In re [2010] 188 Taxman 223 (AAR-New Delhi). We also find force in the submission of Mr. Dastur that even assuming the payment made by the cellular operator is regarded as a payment by way of royalty as defined in Explanation 2 below Section 9 (1) (vi), nevertheless, it can never be regarded as royalty within the meaning of the said term in article 13, para 3 of the DTAA. This is so because the definition in the DTAA is narrower than the definition in the Act. Article 13(3) brings within the ambit of the definition of royalty a payment made for the use of or the right to use a copyright of a literary work. Therefore, what is contemplated is a payment that is dependent upon user of the copyright and not a lump sum payment as is the position in the present case."*

iii) Similar view was taken by the Hon'ble Delhi High Court in Nokia Networks O.Y. (supra) and CIT v/s Dynamic Vertical Software Pvt. Ltd., 332 ITR 222 (Del.).

37. We have also noted that the Special Bench of the Tribunal in Motorola Inc., 95 ITD 269 (Del.) had after analyzing the provisions of Copyright Act and considering the OECD commentary on characterization of income arising from sale of software license held that payment for software license where no right for use of copyright was granted to the licensee such as right to make copies thereof for commercial exploitation does not constitute use of copyright of literary work and is

consequently not *"Royalty"* under the tax treaty entered into by India.

38. Similarly, Mumbai Bench of the Tribunal in ADIT v/s TII Team Telecom International Pvt. Ltd., 12 Taxman.com 502, followed the judgment of the Special Bench in Motorola Inc. (supra) after distinguishing the judgment of the co–ordinate bench in the Grace Mac Corporation v/s ADIT, 42 SOT 550 (Del.) and held that in view of Article–12(3) of India-Israel DTAA, the consideration for payment of standard software would not constitute "Royalty" under the India Israel DTAA.

39. Similar view has been taken by Co–ordinate bench of Tribunal in Financial Software and Systems Pvt. Ltd. v/s DCIT, 47 Taxman.com, 410 (Chennai), wherein it was held that payment made to non–resident companies for procuring standard and copyrighted software could not be treated as payment towards *"Royalty"*. In this judgment, Bench has also considered and distinguished judgment of another judgment of co–ordinate bench in the case of Reliance Infocom Ltd., 39 Taxman.com 140 (Mum.).

40. The Mumbai Bench of the Tribunal in DDIT v/s Solid Works Corporation, 152 TTJ 570 (Mum.), held that the consideration received on sale of Shrink Rap Software was not "Royalty*".* It was business income and in the absence of a P.E., no income

accrued in India. In this judgment, the Bench also dealt with the argument of the Revenue that the principle that where two views are available, the view which is favourable to the assessee should be preferred, does not apply upon a non–resident assessee. The Bench did not accept this argument of the Revenue and held that if the assessee has the benefit of tax concession in view of the provisions of DTAA, then the same cannot be denied to it by applying the provisions of the Act. The concluding para of the judgment of the Bench is reproduced hereunder for the sake of ready reference.

> *"14. Following the view expressed by the Hon'ble Dellhi High Court in the case of DIT Vs. Ericsson AB, New Delhi (Supra), which is favourable to the Assessee, we hold that the consideration received by the Assessee for software was not royalty. The receipts would constitute business receipts in the hands of the Assessee. Admittedly the Assessee who is a non resident does not have a permanent establishment and therefore business income of the Assessee cannot be taxed in India in the absence of a permanent establishment."*

41. Similarly, the Delhi Bench of the Tribunal in Aspect Software Inc. v/s ADIT, ITA no.221/Del./2013, vide its order dated 18th May 2015, interpreted the provisions of Article 12 of the tax treaty and giving benefit of the same, it was held that payment for copyrighted article would not fall within the scope

of term “Royalty”. Relevant Para’s of this judgment are reproduced below:–

41. Before us, the Ld. Counsel for the Assessee as well as the Ld. D.R. relied on several decisions of the High Court and Tribunal rendered on the subject. These decisions are not being considered as the issue is extensively dealt by the Hon'ble Jurisdictional High court in the cases of M/s Ericsson A.B. and Infrasoft Ltd (supra) which are binding on this Tribunal. We observe that all the arguments put forth by the Revenue and the assessee are considered and answered in these decisions. Further, the Delhi High Court in Infrasoft has expressed its disagreement with the view taken by the Karnataka High Court in the case of Samsung Electronics Co Ltd. Hence, the decisions relied by the Ld. CIT-DR in the case of Samsung Electronics and Gracemac Corporation (supra) does not help the case of the Revenue, as we are under the Jurisdiction of the Hon'ble Delhi High Court.

42. In view of the above, respectfully following the decision of Hon'ble Jurisdictional High Court in the case of Ericsson A.B. (supra) and Infrasoft Ltd. (supra), we hold that the consideration received by the Assessee for supply of product along with license of software to End user is not royalty under Article 12 of the Tax Treaty. Even where the software is separately licensed without supply of hardware to the end users (i.e. eight out of 63 customers), we are of the view that the terms of license agreement is similar to the facts of Infrasoft Ltd (Supra). Accordingly, we hold that there was no transfer of any right in respect of copyright by the assessee and it was a case of mere transfer of a copyrighted article. The payment is for a copyrighted article and represents the purchase price of an article.

Hence, the payment for the same is not in the nature of royalty under Article 12 of the Tax Treaty. The receipts would constitute business receipts in the hands of the Assessee and is to be assessed as business income subject to assessee having business connection/ PE in India as per adjudication on Ground No 5."

42. It is further noted by us that Mumbai Bench of the Tribunal in the case of ADIT v/s Antwerp Diamond Bank, N.V., ITA no.7347/Mum/2007, order dated 14th March 2014, analyzing the effect of provisions of Article 12(3) of Indo–Belgium DTAA held that once the assessee had opted for the benefit of DTAA, then there was no requirement for resorting to the definition and scope of *"Royalty"* as given in section 9(1)(vi). Relevant para of the judgment is reproduced below:–

"18. Insofar as the reliance placed by the learned Departmental Representative on the decisions of the Madras High Court and also the scope of "royalty" as given in Explanation 4 and 5 to section 9(1)(vi) brought in statute by the Finance Act, 2012 are concerned, we find that the same is not tenable for the reason that once the assessee has opted for the benefit of the DTAA, then there is no requirement for resorting to the definition and the scope of "royalty" as given in section 9(1)(vi). The said amendment cannot be read into the treaty and will not influence the definition of "royalty", as given in Article 12(3). This proposition is squarely covered by the decision of the Bombay High Court in Siemens Aktiongesellschaft (supra), the decision of Delhi High Court in Nokia Network (supra) and DIT v/s Ericson AB, [2012] 343 ITR 470. Even the decisions of Madras High Court as relied upon by the learned Departmental Representative is not applicable which is evident from the issue involved as is evident from

> *the substantial question of law which were formulated by the High Court for adjudication. Hence, the said decisions are not applicable.*

43. Thus, from the aforesaid judgments, we can safely conclude that if the assessee cannot be fastened with the tax liability taking shelter of provisions of tax treaty, then the same cannot be imposed by applying the provisions of the Act by disregarding and overriding the provisions of the treaty. However, we shall also like to deal with the judgments relied upon by the Ld. Departmental Representative in support of the actions of the lower authorities.

44. Ld. CIT-DR (Departmental Representative) relied upon the two judgment of Hon'ble Karnataka High Court in CIT v/s Synopsis International Old Ltd. (supra) and CIT v/s Samsung Electronics Co. Ltd. (supra).

45. We have gone through both the judgments carefully and find that none of these judgments would be applicable on the facts of the present case for the reason that we have decided this case primarily on the first issue in favour of the assessee on the ground that in the case before us, it was the case of predominantly a transaction of sale of machine by the assessee to its customers and for the customers also it was in effect a transaction of purchase of machine only, and thus it was not a case of sale of software, as such. This issue was not there

before the High Court in these judgments. Therefore, this issue has not been addressed by the High Court.

46. Similarly, other case relied upon by the Ld. CIT-DR of DDIT v/s Reliance Infocom (supra), it is noted that this judgment has based its decision mainly relying upon the aforesaid two judgments of Karnataka High Court. Although, an argument was taken before the Bench in the said case that software was integral part of the hardware but on facts Hon'ble Bench held that the software supplied was not an integral part of equipment nor it was a case of embedded software. But in the case before us, we have held on facts that it is a case of predominantly a transaction of sale and purchase of machine. The software had no independent identity. The substance of the transaction was supply of machine by the assessee and its usage by the customers in whatever manner it was possible i.e., with or without software. Thus, we find and respectfully state that all these judgments as have been relied upon by Ld. CIT-DR are not applicable on the facts of this case before us. It is further noted by us that all these judgments have been discussed and considered by Hon'ble Delhi High Court and other Courts in various judgments. We have respectfully followed the latest judgments available before us.

47. Further, for the purpose of appreciating scope and meaning of Article 12(3) of Indo-Israel DTAA in the context of impugned transactions done by the assessee, we have also analysed the provisions of Copyright Act, 1957, in India to examine whether there was any transfer of copyright or rights therein, in the given facts of this case, by the assessee to its customers in India. In this regard, we find that section 14 of the said Act explains and defines the meaning of term copyright. Relevant part of section 14 reproduced herein:

> *14. Meaning of copyright—For the purposes of this Act, 'copyright means the exclusive right subject to the provisions of this Act, to do or authorise the doing of any of the following acts in respect of a work or any substantial part thereof, namely*
>
> *(a) in the case of a literary, dramatic or musical work, not being a computer programme,-*
>
> *(i) to reproduce the work in any material form including the storing of it in any medium by electronic means;*
>
> *(ii) to issue copies of the work to the public not being copies already in circulation;*
>
> *(iii) to perform the work in public, or communicate it to the public;*
>
> *(iv) to make any cinematograph film or sound recording in respect of the work;*
>
> *(v) to make any translation of the work;*

(vi) to make any adaptation of the work;

(vii) to do, in relation to a translation or an adaptation of the work, any of the acts specified in relation to the work in sub-cls. (I) to (vi);

(b) in the case of a computer programme,-

(i) to do any of the acts specified in cl. (a);

(ii) to sell or give on commercial rental or offer for sale or for commercial rental any copy of the computer programme.

Provided that such commercial rental does not apply in respect of computer programmes where the programme itself is not the essential object of the rental.

48. From the perusal of the above definition what we are able to gather is that none of the clauses is attracted when assessee has sold the machine along with its requisite software to operate and use the machine. The assessee has not given any right, whatsoever, to its customers to resell any copy of the software supplied along with machine, as has been discussed by us in detail in earlier part of this order. The other arguments made on behalf of the Revenue is that the Customers were supplied the software through email and other electronic medium and they has also made copies of the software programme for the purpose of loading it the machine and creating back-up files. It is noted that even this apprehension of the Revenue has been taken care of by the Copyright Act. Section 51 of the Act lists out those situations 'when copyright

is infringed or deemed to be infringed. Further, section 52 of the Act, carves out exception to section 51 and lists out certain acts not to be considered as infringement of copyright. Section 52 states that the following acts shall not constitute an infringement of copyright, namely-

"*……*

(aa) the making of copies or adaptation of computer programme by the lawful possessor of a copy of such computer programme, from such copy-

(i) In order to utilize the computer programme for the purpose for which it was supplied; or

(ii) to make back-up copies purely as a temporary protection against loss, destruction or damage in order only to utilize the computer programme for the purpose for which it was supplied."

Thus, from the above, it is clear that if customer makes requisite copies to enable it to use the software for exclusively its own purposes or makes back-up copies purely as a temporary protection against loss, in order only to utilize the computer programme for the purpose for which it was supplied, then section 52 of the Act clearly states that it shall not amount to infringement of the copyright. Thus, in the facts of this case which we have discussed in detail above, neither there was any transfer of copyright or any rights therein nor there was any situation giving rise to any type of infringement of copyright by the customers of the assessee. Thus, in our considered view account of sales consideration received by the assessee on account of sale of machine along with it operating software would not constitute "Royalty" within the meaning of article 12(3) of the Indo-Israel DTAA.

49. Apart from that, we find that Hon'ble Supreme Court has observed time and again in some of its judgments that where two views are available, then the view favourable to the assessee should be followed, in the interest of justice and harmony. We are reminded of a recent judgment of Hon'ble Supreme Court in CIT v/s Vatika Township Pvt. Ltd., 367 ITR 466, wherein similar view has been reiterated by the Hon'ble Supreme Court by making the detailed observations on this aspect. Relevant portion of the judgment is reproduced below:–

> *"……….At the same time, it is also mandated that there cannot be imposition of any tax without the authority of law. Such a law has to be unambiguous and should prescribe the liability to pay taxes in clear terms. If the concerned provision of the taxing statute is ambiguous and vague and is susceptible to two interpretations, the interpretation which favours the subjects, as against the revenue, has to be preferred. This is a well established principle of statutory interpretation, to help finding out as to whether particular category of assessee are to pay a particular tax or not. No doubt, with the application of this principle, Courts make endeavor to find out the intention of the legislature. At*

the same time, this very principle is based on "fairness" doctrine as it lays down that if it is not very clear from the provisions of the Act as to whether the particular tax is to be levied to a particular class of persons or not, the subject should not be fastened with any liability to pay tax. This principle also acts as a balancing factor between the two jurisprudential theories of justice - Libertarian theory on the one hand and Kantian theory along with Egalitarian theory propounded by John Rawls on the other hand.

Tax laws are clearly in derogation of personal rights and property interests and are, therefore, subject to strict construction, and any ambiguity must be resolved against imposition of the tax. In Billings v. U.S., the Supreme Court clearly acknowledged this basic and long-standing rule of statutory construction:

"Tax Statutes ... should be strictly construed, and, if any ambiguity be found to exist, it must be resolved in favor of the citizen. Eidman v. Martinez, 184 U.S. 578, 583; United States v. Wigglesworth, 2 Story, 369, 374; Mutual Benefit Life Ins. Co. v. Herold, 198 F. 199, 201, affd 201 F. 918; Parkview Bldg . Assn. v. Herold, 203 F. 876, 880; Mutual Trust Co. v. Miller, 177 N.Y. 51, 57………………."

50. Although, the stand of the Revenue has been that there were two views available on this issue but we find that in the facts of the case before us, the judgments quoted by the Revenue are not applicable and are distinguishable from the facts of the case before us. We further find that latest views coming from Hon'ble Delhi High Court and other Courts are leaning more towards the views in favour of the assessee on

the issue before us and, therefore, under such circumstances and in the interest of justice and fairness we have preferred to follow more recent judgments brought before us by the parties. Our approach is also in live with the guidance given by Hon'ble Supreme Court in the case of Vatika Township, (supra).

51. Before we part with, we shall like to clarify and reiterate at the cost of repetition that we have not examined the effect of subsequent amendment to section 9(1)(vi) of the Act and also whether the amount received for use of software would be "Royalty" in terms thereof for the reason that the assessee is covered by tax treaty the provisions of which are more beneficial and also for the reason that in this case transaction under consideration was predominantly and essentially of the character of sale and purchase of machine and not that of software.

52. Thus, in view of the discussion above, it is held that the amount received by the assessee was not liable to tax as "Royalty" and therefore addition made by the Assessing Officer is directed to be deleted. Grounds no. 2 to 5 are partly allowed.

53. In ground no. 6, assessee has contended that it has not been allowed credit of TDS amounting to Rs 8,52,664, while

finally computing the income tax liability although the same was directed to be allowed in the assessment order.

54. During the course of hearing it was requested by the Ld. Counsel for the assessee that the assessee would be satisfied if some directions are given to grant credit of TDS as per law and facts. No objection was raised by the Ld. CIT-DR in this regard.

55. In view of the submissions of the parties, we direct the Assessing Officer to look into this aspect and grant credit of TDS after verifying the requisite facts. This ground is treated as allowed for statistical purposes.

56. In Ground no.7, the assessee has challenged the action of the Assessing Officer in levying interest under section 234B of the Act.

57. During the course of hearing, the assessee submitted that assessee was not required to pay advance tax in view of the tax being deductible at source, in view of the judgment of Hon'ble Jurisdictional High Court in DIT v/s NGC Network Asia LLC, 313 ITR 187 (Bom.).

58. Since we have already decided this issue in favour of the assessee and held that impugned income of the assessee was

not liable to be taxed and, therefore, as of now this ground becomes infructuous and therefore, dismissed as such. Ground no.7 is dismissed.

59. Ground no. 8 is with regard to initiation of penalty proceedings under section 271(1)(c) of the Act.

60. We find the same to be pre–mature and, therefore, dismissed as such. Ground no.8 is dismissed.

61. In the result, appeal may be treated as partly allowed for statistical purposes.

Pronounced in the open Court on 24.02.2016.

Sd/-
(C.N. PRASAD)
JUDICIAL MEMBER

Sd/-
(Ashwani Taneja)
ACCOUNTANT MEMBER

MUMBAI, DATED: 24.2.2016
Copy of the order forwarded to:

(1) The Assessee;
(2) The Revenue;
(3) The CIT(A);
(4) The CIT, Mumbai City concerned;
(5) The DR, ITAT, Mumbai;
(6) Guard file.

By Order

Pradeep J. Chowdhury
Sr. Private Secretary

(Dy./Asstt. Registrar)
ITAT, Mumbai